

# Wealth Insights

TD Wealth Private Investment Advice

Winter 2019

## Keeping Perspective

The turning of a new year is synonymous with optimism and hope. Yet after a rough year for the Canadian equity markets, it may feel as though optimism is in short supply.

But here are some thoughts to help keep perspective. We are living in one of the most prosperous times in history. Income and quality of life have improved; disease, violence and child mortality have fallen. Though the world is far from perfect, necessities and luxuries alike are more affordable. Just 20 years ago, a 50-inch plasma TV would cost around \$10,000; today a similar TV costs less than \$600.<sup>1</sup> Consider that these technologies didn't exist 50 years ago: smoke detectors, cell phones, pocket calculators, global positioning systems (GPS).

In just 50 years, our standard of living has more than doubled. In 1968, Canada's Gross Domestic Product (GDP) per capita was around \$27,600 (in today's terms) when adjusted for inflation. Today, GDP per capita sits at around \$60,000.<sup>2</sup> Back in 1968, our life expectancy was 72 years. Over two generations, it has increased by almost a full decade.<sup>3</sup> Throughout this time, investors saw the S&P/TSX Composite Index appreciate over 5.9 percent on an annualized basis.<sup>4</sup>

Yet, even during this period of growth:

- Annual inflation was greater than 5 percent in 13 of those years.<sup>5</sup>
- The stock market fell over 232 of those 600 months.<sup>6</sup>
- The S&P/TSX Composite Index lost a quarter of its value at least seven times.<sup>6</sup>
- There were nine bear markets lasting a total of 75 months.<sup>6</sup>
- We experienced five recessions, cumulatively lasting over five years.<sup>7</sup>

This should remind us that even with significant progress, setbacks are a natural occurrence. There is no doubt that we face many

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challenges. Trade tensions have been a source of market volatility. Canada's competitiveness remains a concern. GDP growth has slowed, foreign direct investment has fallen and our energy sector, a significant component of the Canadian equity markets, continued to face headwinds. The price differential between Western Canada Select oil produced here at home and the benchmark U.S. West Texas Intermediate oil highlighted the problems of getting our oil to broader markets. While the federal government acknowledged these challenges in its November 2018 fiscal update, it is yet to be seen if the proposed measures will help to improve competitiveness.

Despite the challenges, consider that having a wealth plan in place and participating in the equity markets can offer an advantage over the longer-term. While history has shown that you are likely to experience recessions, pullbacks and perhaps even a market crash, the stock market has also been one of the greatest wealth generators over time. If you can persevere through the ups and downs, it's likely that you will reap the returns.

We are here to support you and wish you much health and happiness for the year ahead.

1. <https://nytimes.com/1999/01/14/technology/flat-tvs-still-for-the-fat-wallet-set-improve-as-prices-fall.html>; 2. Statistics Canada, Thomson Reuters, IMF WEO; 3. [statcan.gc.ca/eng/help/0bb1nfo/01](http://statcan.gc.ca/eng/help/0bb1nfo/01); 4. S&P/TSX Composite Index, 1/1/68 to 4/30/18; 5. inflation.eu/inflation-rates/canada/historic-inflation/cpi-inflation-canada.aspx; 6. S&P/TSX Composite Index, 4/30/18; 7. [cdhowe.org](http://cdhowe.org).



## Planning Ahead

# Make 2019 Less Taxing

What did you do to reduce your tax bill last year? Perhaps you can do better in 2019 — the time to start is now. Here are a few suggestions to start your thinking:

**1. Contribute to your registered Retirement Savings Plan (RSP).** Consider whether to make a personal contribution or a spousal contribution. If one spouse has the prospect of having a high level of income in retirement while the other will not, a spousal RSP may provide an income-splitting opportunity.

**Reminder:** Deadline for 2018 RSP contributions is **Friday March 1, 2019**. Consider an automatic monthly contribution plan to minimize any impact of missing the deadline.

**2. Contribute to your Tax-Free Savings Account (TFSA).** The annual TFSA contribution limit for 2019 is \$6,000. The total TFSA contribution amount is \$63,500, for eligible individuals who have not made contributions since its inception in 2009.

**3. Split income, save tax.** Review your family's potential tax bill to determine if income-splitting opportunities exist. Talk to a tax professional about reducing your family's overall tax bill. This may include paying reasonable salaries to spouses/children for services provided to a self-employed business/private company, splitting eligible pension income with a spouse on a tax return, or setting



up a loan at the prescribed interest rate where proceeds are used for investment purposes by a spouse.

**4. Get organized for tax season.** While personal income tax returns will not be top of mind for a few months, why not organize your records before the crunch season approaches? This may prevent medical expenses, donations, business charges and other receipts from being missed or overlooked. Consider starting a 2019 tax folder and begin the new tax year on good footing.

**5. Plan for your business.** If you are a small business owner, speak to a qualified professional to review the options for your business for the year ahead, now that new passive income rules for Canadian-controlled private corporations are in effect for taxation years commencing after 2018.

Tax planning continues to be an important part of investing. If you need assistance with any of these ideas, please call or seek advice from a tax professional.

## Investing for the Future

# Debunking the RSP Myths

Participation rates for the registered Retirement Savings Plan (RSP) have been declining over recent years. In fact, many Canadians may believe there is “no point” in investing in them because taxes eventually have to be paid in retirement. But the RSP can provide a substantial tax advantage. Let's debunk some of the myths:

**Myth: There is no point in investing in an RSP as you pay all the savings back in taxes when you retire.**

While you do pay tax on RSP withdrawals, don't forget that you received a tax deduction when funds were contributed. This is often overlooked; people confuse pre-tax with after-tax dollars. A \$4,000 RSP contribution is equivalent to a \$2,800 after-tax contribution to a non-registered account at a 30 percent marginal tax rate.

**Myth: The RSP is disadvantaged because investment earnings are subject to higher taxes, since withdrawals incur tax at regular rates, whereas capital gains realized in a non-registered account are taxed at lower rates.**

If you assume a constant marginal tax rate and adjust for pre-tax and after-tax amounts, the RSP will potentially outperform a non-registered account holding identical investments. The following chart shows a scenario with this outcome, in which a pre-tax contribution of \$4,000 has been made for 20 years. The

example assumes a 30 percent marginal tax rate and growth of capital at 5 percent.

### Scenario: After-tax Difference of RSP vs. Non-Registered Account

	RSP Account	Non-Registered Account
Pre-tax annual contribution	\$4,000	\$4,000
After-tax contribution: 30% tax rate	n/a	\$2,800
Total contribution over 20 years	\$80,000	\$56,000
Growth over 20 years at 5%	\$138,877	\$97,214
Tax at withdrawal at 30%	\$41,663	\$6,182 <sup>1</sup>
Net after-tax amount	\$97,214	\$91,032
<b>Difference</b>	<b>+6.8%</b>	

1. Realized capital gain of \$97,214 - \$56,000 = \$41,214, taxed at 50% inclusion rate.

This net after-tax amount will vary depending on circumstances such as your time horizon, actual rates of return and applicable tax rates. In addition, the tax liability may be less if you are in a lower marginal tax bracket at the time funds are withdrawn, which is often the case for retirees.

As such, don't overlook the potential tax-deferral benefits of compounding over time through the use of the RSP.

## Our Aging Population

# Preventing Elder Abuse

Nobody wants to believe that elder abuse could happen to someone they love. But with estimates indicating that about 10 percent of elderly individuals may suffer from abuse,<sup>1</sup> there is reason to be concerned. Financial abuse is one of the most common types of elder abuse and it can take many forms, from bullying, manipulating or theft to financial scams. Sadly, it may be relatives or friends who are responsible for the abuse.<sup>2</sup>

Here are some signs that may indicate financial abuse:

- **Unusual financial activity** — Unexplained account activity, including withdrawals or credit card charges, may indicate that an elderly individual is being coerced. Sometimes funds are “borrowed” but never repaid; cheques may be cashed without authorization, or by forging a signature.
- **Missing valuables** — Lost items may indicate abuse, but this can easily be dismissed if a person suffers from cognition problems. Helping to locate missing valuables can determine if the issue is simply confusion, or if it signals a larger problem like abuse.
- **Appearance of a new friend** — A new companion may be cause for concern if warning signs are present, such as unusual financial activity or missing personal effects.
- **Changes to important legal documents** — Unexplained changes to important documents, such as a will or power of attorney documents, may indicate potential abuse. Sometimes seniors are coerced or deceived into signing documents.

While there are often signs, elder abuse may be difficult to uncover and can continue for long periods of time. Victims may become secretive because they feel ashamed or embarrassed, or fear punishment or retaliation from their abuser.

One way to help prevent elder abuse is to take steps in advance to protect those who may be vulnerable:

**Prevent isolation** — Form a wide support network of family,



friends and professional advisors. These individuals can help identify problems and intervene where necessary. Widening an elderly person’s network can help to provide support from trustworthy sources.

**Check in** — Call and visit as often as possible or find a trusted confidante to check in. This can help to identify warning signs that may indicate abuse. Listen closely to the elderly individual when they share information. Ask questions, and never dismiss potential red flags.

**Offer support** — Offer simple support with finances, such as conducting a quick scan of bank or credit card statements to make sure things are in order. Or, provide support for larger projects, such as helping to update financial documents or conduct a credit check. These reviews may uncover abuse.

**Put safeguards in place** — Plan ahead and grant a power of attorney to a trusted individual. Consider appointing a professional (such as a trust company) to work alongside a family member to help provide a safeguard.

Many resources are available to provide support. A starting point is the Government of Canada website: [canada.ca/en/employment-social-development/campaigns/elder-abuse/financial-reality.html](http://canada.ca/en/employment-social-development/campaigns/elder-abuse/financial-reality.html)

1. <http://www.carp.ca/2016/10/14/elder-abuse-widespread-problem/>; 2. <https://cnpea.ca/images/canada-report-june-7-2016-pre-study-lynnmcdonald.pdf>

## New Year Resolutions: Keep Time on Your Side

*“You may delay, but time will not.”*

- Benjamin Franklin

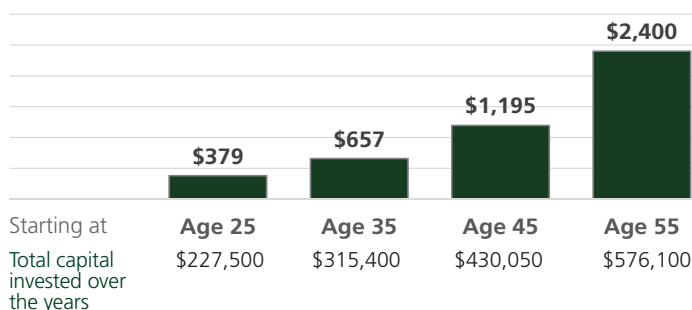
It is often said that procrastination is the thief of time. As we begin another year, don’t let procrastination preclude you from using time wisely to generate wealth.

Perhaps there is an opportunity to put funds to work that are currently sitting on the sidelines. Or how about passing along some financial wisdom to younger generations, teaching them the value of time and compounded growth?

The chart to the right shows the impact that time can have on generating retirement savings. It illustrates how an investor would need much less capital the earlier they start investing in order to accumulate a \$1 million nest egg by the age of 75.

Remember that time can be one of an investor’s greatest allies.

**Estimate Monthly Amount Needed to Accumulate \$1M by Age 75**  
(Assuming a 5 Percent Compounded Annual Rate of Return)



Note: Assumes a return of 5 percent compounded annually on the annual amount invested, with taxes and expenses ignored. The estimate monthly amount equals the annual investment amount divided by 12. For illustrative purposes only.

# Whole Life Insurance as Part of a Balanced Portfolio

If you are looking to potentially improve returns while reducing risk as part of a broader portfolio strategy, the solution may be through the use of life insurance. If you have excess funds not needed in retirement, “participating whole life insurance”, known as a “par policy”, can provide a compelling case to achieve exposure to fixed income, such as bonds, as part of a balanced portfolio, especially in a low-yield environment.

In general, a par policy requires the policy owner to deposit premiums, either for a set duration or for life, which are funded with after-tax dollars. In return, the policy owner receives both a death benefit and the proceeds from a separate participating investment account managed by the insurance company. These amounts will be received tax-free by the policy’s beneficiary upon the death of the life insured.\*

Often, the assets in the participating investment account are longer-term debt instruments, such as public and private fixed-income investments, bonds and mortgages. The account would also generally include some real estate and equity holdings. It may therefore provide the policy owner with access to a low-cost, widely diversified portfolio that is often difficult to replicate for individual investors.

## Potential for Improved Returns

No tax is payable on income in the participating investment account, compared to income from a fixed-income portfolio of investments that would be taxable in a non-registered account. In addition, the insurer determines on an annual basis if the policy is to be credited with policy owner dividends, which can be structured to purchase additional death benefit coverage. This may provide the policy with the potential to outperform the fixed-income component of a balanced portfolio.



## Liquidity

Normally, the funds directed towards a par policy would not be required by the policy owner to fund their lifestyle. However, if circumstances were to change, the policy owner may be able to borrow against the cash value of the policy to meet their financial needs. Financial institutions will usually lend a portion of the policy’s cash value and allow the interest to be capitalized. Upon death, part of the death benefit would be used to repay the loan. There may be tax consequences to policy loans and loan repayments in certain situations.

## Business Owners

For business owners, a par policy can also provide tax benefits if held inside a corporate structure. This is because the death benefit (less the adjusted cost base of the policy) can potentially be distributed to the shareholder(s) of the company tax free through the Capital Dividend Account. If the business had instead held a portfolio of predominately fixed-income investments, it is likely that the majority of the assets would be distributed to the shareholders as a taxable dividend.

If you believe that a participating whole life policy could play a strategic role in your asset mix, please get in touch.

\*As long as the policy qualifies as an exempt policy under the Income Tax Act (Canada). To apply for insurance coverage, a need for life insurance protection must be demonstrated.

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